USWEST

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Melissa Newman
Executive Director -Federal Regulatory

February 19, 1999

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Mail Stop 1170
Washington, DC 20554

RE: CC Docket No. 96-98

Dear Ms. Salas:

On Thursday, February 18, 1999 Bruce Posey, Senior Vice President, Federal Relations and Regulatory Law, Professor Alfred Kahn, Timothy Tardiff and the undersigned met with Commissioner Ness, James Casserly, Senior Legal Counsel and Anita Wallgren to discuss U S WEST's position on Competition for New Broadband Telecommunications Services: The Proper Role of Regulation. Please include this letter and the attachment in the record for the above referenced proceeding.

In accordance with Section 1.1206(b)(2) of the Commission's rules, the original and one copy of this letter, with attachment, are being filed with your office. Acknowledgment and date of receipt of this transmittal is requested. A duplicate of this letter is included for this purpose.

Please contact me should you have any questions concerning this matter.

Sincerely,

Melissa Newman

Attachment

CC: James Casserly
Anita Wallgren

No. of Copies rec'd 0+1
List ABCDE

U S WEST Communications, Inc.
CC: Docket No. 96-98

FCC Ex Parte Presentation
February 18, 1999

Bruce Posey
Melissa Newman

Professor Alfred Kahn
Timothy Tardiff

Competition for New Broadband Telecommunications Services: The Proper Role of Regulation

- The market for broadband services seems likely to grow very rapidly:
  - Residential broadband forecast: see attached table on projected residential demand
  - These are *new services*, not traditional public utility services
  - It is anticipated that they will best be supplied not by a single franchised monopolist, but competitively
  - In fact, unregulated companies using cable, led by AT&T, have a head start over ILECs
  - The logic of not regulating them is the same as the logic of deregulating cable
  - Schumpeterian considerations

- What we are seeing is economies of scope in action
  - Firms offering services in "core" market—both franchised, regulated public utilities (the ILECs) and deregulated or unregulated companies—using cable or wireless—are branching out into new markets and/or invading other, existing markets, just as the Telecommunications Act intended.
  - Competition is not confined to telecommunications companies: at least 32 electric utilities have begun to offer telephone and/or video services (e.g., RCN in the Northeast)
  - Benefits
    - More rapid innovations, producing very large consumer benefits
    - Reduced production costs, as preexisting and new services share inputs across the services they produce
    - Large consumer benefits from the faster introduction of new services
- Not only are these not traditional public utility services, they are not being supplied by firms—including ILECs—regulated on the historical rate base rate of return basis; on the contrary, the investments by both unregulated companies and regulated telephone companies are not only very large but also risky, with no assurances of cost recovery. (Would the ILECs have any assurance of recovery of costs, which have been the logical counterpart of public-utility-type sharing obligations in the past? Inappropriateness of such regulation for big new risky innovations in providing innovative services.)
- Questions: Should these ventures into new territories be regulated at all? If so, to what extent and how?
  - AT&T's answers (Ordover and Willig)

- "It would be against the public interest to subject the parties' last mile broadband data transport facilities to any form of regulation at this time."
- "There are many competitors, including the ILECs, that are actively developing broadband transport services." "The xDSL services that are currently being deployed by the incumbent LECs alone constitute a significant and attractive commercial alternative to the internet cable services that TCI and others offer." *But AT&T/cable is ahead and the competitive potential of xDSL may not materialize if its providers are artificially handicapped.*
- "[The] demand to unbundle broadband transport will engender intrusive regulation of an emerging new service that requires massive entrepreneurial investments and whose marketplace success is far from assured." "Forced unbundling with its attendant regulatory uncertainty would likely slow down the investment in the development of broadband last mile investment. Investing under the shadow of uncertain regulatory rules in an <u>innovative</u> service exacerbates the already substantial risks associated with that investment."

❖ The identical considerations apply to the broadband offerings of ILECs—and especially if their required sharing is to be at TELRIC pricing

❖ Essentiality of unregulated competitive symmetry

❖ Regulation of the ILECs alone

- ➢ Unbundling requirements
  - Should there be any, beyond perhaps the ordinary subscriber loops
  - If unbundling requirements, at regulated rates, would be counterproductive for AT&T/TCI and others, they would be similarly so for the ILECs
  - To what extent do or should ILECs have a duty to share their scope economies
- ➢ Separate subsidiary requirements
  - Inevitable sacrifice of economies of scope: Computer II vs. Computer III—a step backward
  - Consequent competitive asymmetry

❖ Regulatory symmetry

Residential Broadband Demand (million)

	Forrester			
	1998		2002	
Cable Modems	0.7	97%	13.6	86%
xDSL	0.025	3%	2.2	14%
Total	0.725		15.8	

	IDC			
	1998		2002	
Cable Modems	0.63	97%	8.15	66%
xDSL	0.021	3%	4.23	34%
Total	0.651		12.38	

Cellular Telephone at Comparable Stage

1986	1990	1993
0.68	5.3	16.0